



COMMITTEE ON BUDGET & FISCAL REVIEW
Room 5019, State Capitol
Sacramento, CA 95814

SENATOR DENISE MORENO DUCHENY, CHAIR

**BUDGET CONFERENCE COMMITTEE
HIGHLIGHTS
(MAJORITY VOTE)**

June 29, 2009

The purpose of this document is to provide members and staff of the State Senate with a broad summary of the actions adopted by the Budget Conference Committee. If you have questions, please contact the committee at (916) 651-4103.

Please note that this is not a comprehensive analysis of all the Final Conference Committee actions, but is rather a high level analysis. This report is a compilation of the original "Highlights" dated June 17, with modifications that take into account the majority vote measures being acted on on June 29.

OVERVIEW OF BUDGET CONFERENCE COMMITTEE ACTIONS (majority vote)

On June 16, the Budget Conference Committee concluded a large portion of its work by adopting a balanced approach to closing the multi-billion dollar gap in the 2009 Budget since its passage in February.

The Conference Committee (this year comprised of 10 members of each house of the Legislature) heard public testimony for over two weeks – thousands of concerned citizens and their locally elected representatives presented their views and suggestions regarding the Governor’s May Revise proposals.

After this period of public testimony, the Conference Committee began its process of deliberation and discussion. The challenge of the Conference Committee was to make difficult, but significant, reductions in all subject areas of the budget; maximize, to every extent possible, the receipt of available federal funds; limit the expansion of unnecessary bureaucracy, while maintaining the state’s infrastructure of education and health/human services for its children, senior citizens, and most needy persons.

Beginning June 24, the Legislature attempted, on a two-thirds vote, to pass a package of bills that represented all the final actions of the Conference Committee; however, the package (a combination of measures intended to (a) garner savings in the current 2008-09 fiscal year, and (b) create savings and increase revenues in 2009-10) had yet to receive the necessary votes for passage.

On June 29, in the absence of a two-thirds vote, the Legislature put forth a package of 14 majority vote measures, in the 3rd Extraordinary Session, intended to provide necessary savings and revenues that would assist the State from falling into a fiscal abyss.

Assuming passage, by June 30, of various current year (2008-09) changes, it is estimated the General Fund savings erosion is approximately \$44 million (assuming an October 1, effective date) and erosion from revenue accelerations and enforcements and non-inclusion of provisions to close some recently-enacted tax loopholes would be less than \$80 million.

Below is a listing of the more significant changes related to implementation via majority vote in the 3rd Extraordinary Session:

Health

- \$18.3 million in lost savings due to loss of Quality Assurance Fee revenue.
- \$17.1 million less in costs due to the loss of various appropriations, reappropriations, and deficiencies.

Human Services

- \$2 million in lost savings from later start date of IHSS Share-of-Cost Proposal.
- \$5.3 million in lost savings from delay of other IHSS policy change savings.

Resources

- \$4 million in lost savings from Toxic Safety Account fee increase.
- \$2.4 million in lost savings from the OEHHHA Fund shift to special funds.
- \$13.1 million less in costs due to loss of park appropriation and oil severance tax administration.

Transportation

- No changes.

Education

- No changes.

Higher Education

- No changes.

Public Safety

- \$9 million in lost savings due to delay in implementing Parole/Institution Population reform proposals.
- \$5 million in lost savings due to delay in implementing Fee for Forensic Lab Services.
- Courts lose various fees to cover their unallocated reduction and, although not a GF impact, the loss in revenue projected from these fees, along with the delay in the court closure proposal, will put additional burden on the Administration Office of the Courts and trial courts.

General Government

- Office of the Chief Information Officer (OCIO) technical changes are no longer contained in the budget.
- \$3 million for Proposition 11 redistricting activities at Bureau of State Audits is taken out of bill.
- Loss of various appropriation of various staff at tax agencies for enforcement.
- \$50 million for additional cash borrowing costs are not able to be appropriated.

Major elements of the plan:

The overall architecture of the Budget Conference Committee's plan includes: (1) over \$10.4 billion in program reductions and savings; (2) approximately \$1 billion in reductions, primarily from the Medi-Cal program – that require federal action (this is consistent with the Governor's May Revise proposal); (3) revenue accelerations and fee increases of approximately \$5 billion; (4) fund shifts of about \$2.6 billion; (5) enhanced revenue enforcement collections of \$143 million; (6) rejection of borrowing \$2 billion (Proposition 1A) from local government; (7) increased taxes – primarily on cigarettes and oil severance – \$1.9 billion; and (8) other proposals of \$2.2 billion (which includes the sale of the State Compensation Insurance Fund [SCIF] as proposed by the administration).

In total, after all actions are taken into account, the Budget Conference Committee provides for an approximately \$3.8 billion General Fund reserve for 2009-10.

Below, by major subject matter area, are some of the significant changes adopted by the Conference Committee.

EDUCATION

- **Overall Proposition 98 & K-12 Reductions:** Adopts \$5.5 billion in Proposition 98 reductions for K-14 education over two years. This includes \$4.5 billion in reductions for K-12 education, involving the following major adjustments:

- \$1.3 billion in revenue limit reductions in 2008-09 and about \$1.9 billion in revenue limit reductions in 2009-10. These amounts include commensurate categorical reductions for Basic Aid Districts.
 - \$1.7 billion in deferral savings achieved by shifting revenue limit payments from 2009-10 to 2010-11.
 - \$282 million to partially restore Home-to-School Transportation funding for local educational agencies (LEAs) (on top of \$214 million already budgeted) and \$3.9 million to fully restore transportation services at the State Special Schools in 2009-10, due to the elimination of special funds.
- **Home-to-School Transportation Details:** Provides total funding of \$496 million in Proposition 98 funding for Home-to-School Transportation. This level of funding equates to a program reduction of nearly 20 percent, which is in line with reductions for other categorical programs. These funds are then added to the categorical flexibility program.
- **Federal Funds.** Authorizes a significant increase in federal funds in 2009-10 – primarily new, one-time, funds authorized under the ARRA (American Recovery and Reinvestment Act), including:
- About \$500 million in anticipated ARRA Stabilization Funds to backfill K-12 revenue limit reductions and related categorical reductions for Basic Aid Districts;
 - \$634 million in anticipated ARRA Individuals with Disabilities Education Act (IDEA) funds for students with disabilities;
 - \$540 million in anticipated ARRA Title I Basic Grants for low-income students;
 - \$165 million in available Title I Set-Aside funds -- including new ARRA funds -- to be allocated to LEAs using Title I student counts;
 - \$403 million in anticipated ARRA School Improvement Grant funds that are set aside pursuant to legislation.

➤ **Flexibility.** Provides K-12 LEAs with additional program and funding flexibility, beyond what was provided in February, as follows:

- Suspends the High School Exit Exam as a requirement for graduation, beginning in 2009-10;
- Allows school districts to reduce the number of instructional days by five – from 180 to 175 days per year – through 2012-13 without losing longer-year incentive grants (modified Governor’s proposal);
- Suspends the LEA requirement to purchase newly adopted instructional materials through 2012-13 and prohibits the State Board from initiating any new adoptions during this period;
- Allows school districts to sell surplus property not purchased with state funds and use proceeds for general fund purposes for nearly three years (Governor’s proposal);
- Suspends the remaining routine maintenance reserve requirement of one percent through 2012-13 for school districts that meet the facility requirements of the Williams settlement (Governor’s proposal);
- Provides LEAs with access to additional, prior-year fund balances in 2009-10 beyond those provided in February. Additions include: Targeted Instructional Improvement Grants; Instructional Materials; California High School Exit Exam; Adult Education; ROC/P Facilities; and Deferred Maintenance. (Economic Impact Aid; Special Education; Home-to-School Transportation; QEIA; Child Development; and Child Nutrition are protected. Modified Governor’s proposal.)

➤ **Fiscal Oversight Relief**

- Changes the minimum requirement for reserves for economic uncertainty to one-third of the currently required level in 2009-10, provided that LEAs make annual progress in restoring reserves and fully restores reserves in 2011-12.

- Allows LEAs to avoid a negative or qualified fiscal certification due to a substantial loss of federal ARRA Stabilization Funds in 2011-12 and 2012-13. To ensure consistent statewide implementation, the Superintendent of Public Instruction shall convene the Standards and Criteria Committee to modify the budget and fiscal review criteria to incorporate these changes.

➤ **Proposition 98 Maintenance Factor**

- Adds statute that entitles school districts and community colleges to Proposition 98 maintenance factor in years when Test 1 is operative and lower than Test 2. These provisions would become effective July 1, 2011.

➤ **Child Care**

- Fully funds Stage 2 and Stage 3 child care services.
- Adds \$15.5 million from Federal ARRA funds for additional child care slots for low-income families.
- Eliminates the Extended Day Care Program, which is redundant of the Prop 49 After-School Education & Safety program, effective September 1, 2009.
- Denied Governor's proposal to increase family fees and decrease reimbursement rates for child care providers.

HIGHER EDUCATION

➤ **Community Colleges**

- Reduces funding by approximately \$700 million for community colleges consistent with the Proposition 98 minimum funding guarantee and the funding levels proposed by the Governor in the May Revise.
- Provides smaller reductions to priority categorical programs, and places many (but not all) categorical programs into a flexible pot. Provides community colleges with some flexibility to achieve savings.

- Increases student fees by \$6 per unit (to \$26 per unit), consistent with pre-2007 levels. The additional fee revenue provides community colleges with \$80 million in funds to offset necessary reductions. However, no reduction is made in the area of financial aid administration, ensuring that there are resources for students to find financial assistance.
 - Provides community colleges with \$130 million in federal economic stimulus funds to offset cuts.
- **University of California / California State University**
- Total reductions of \$1.4 billion in the current year (\$717.5 million to each segment) and \$266 million to each segment (total of \$532 million) in 2009-10 are equal to the Governor's May Revise proposal, but unlike the Governor's proposal, cuts are equalized between UC and CSU. Of these total reductions – \$1.97 billion over two-years – approximately \$1.7 billion will be offset by federal economic stimulus funds.
 - Does not eliminate funding for academic preparation as proposed by the Governor, but rather achieves savings through unallocated reductions.
- **Hastings College of the Law.** Rather than eliminate all funding for Hastings, the conference committee adopted a 10 percent reduction.
- **Student Financial Aid**
- Does not eliminate the Cal Grant Financial Aid Program.
 - Achieves substantial savings by transferring \$32 million in excess funds in the Student Loan Operating Fund to the General Fund to offset Cal Grant costs.
 - Makes reductions to the Cal Grant Program, but makes cuts effective for 2010-11. Reductions include freezing the income eligibility level at the current thresholds for Cal Grant A recipients for one year and reducing the maximum awards for students attending private colleges.

HEALTH

- **Healthy Families:** Rejects elimination of the program, but achieves substantial savings of approximately \$70 million, by establishing a waiting list for enrollment unless third-party philanthropic organizations, donations, or other sources, become available to continue enrollment of children throughout the year.
- **Medi-Cal:** Does not adopt the Governor's proposals to eliminate Adult Day Health Care, state-only programs, clinic programs, services for legal immigrants, or recent family planning rate increases. Rather, it makes redirections to provide rates in selected areas, seeks federal repayment for certain Medi-Cal expenditures and makes other related reductions.
 - Reduces by about \$2.8 billion (GF) to reflect receipt of enhanced federal funds as provided under the American Recovery & Reinvestment Act (ARRA).
 - Assumes receipt of \$1 billion in federal funds for repayment to California for expenditures made within the Medi-Cal Program which should have been funded by the federal government, including expenditures which should have been provided under the federal Medicare Program.
 - Adopts the Governor's unallocated reduction of \$323.3 million (GF).
 - Reduces by \$22.5 million (GF) by requiring pharmacies to bill Medi-Cal at a rate that is comparable to private third-party payers as specified in trailer bill language.
 - Reduces by \$37 million (GF) by making changes in the Medi-Cal reimbursement made to pharmacies as it pertains to the estimated acquisition cost of drugs.
 - Reduces payments to hospitals by sweeping the Distressed Hospital Fund for a savings of \$23 million (GF).
 - Reduces Adult Day Health Care coverage to three days per week and related changes, for a savings of \$26.8 million (GF).

- ~~Increases fees paid by skilled nursing facilities by expanding the amount of revenue upon which the AB 1629 fee is based, to include Medicare revenue, for increased revenue to the State of \$18 million.~~
 - Suspends cost-of-living increases effective August 1, 2009, for skilled nursing facilities and other long-term care for a General Fund savings of \$75.8 million in 2009-10.
 - Reduces by \$14 million (GF) to reflect the elimination of the state-only payment for ancillary health services provided in Institutions for Mental Disease (IMDs).
- **Other Health Programs:** Does not adopt Governor's proposals to eliminate funding for AIDS drugs, HIV education and prevention, domestic violence shelters, maternal and child health programs. Rather, reduces funding in a more rationale manner:
- Maternal and Child Health: Rather than total elimination of the various programs and services offered, a reduction of \$11.5 million was adopted.
 - Community-Based Clinics: Rather than total elimination as proposed by the administration, the conference committee: (a) reduced Rural Health Services by \$2.2 million; (b) reduced Seasonal Migratory Worker services by \$1.9 million; and (c) reduced Expanded Access to Primary Care Clinics by \$8.4 million (total funds).
 - HIV/AIDS: Rather than total elimination of these programs, a reduction of \$33.5 million was adopted without jeopardizing federal Ryan White funding and utilizing AIDS Drug Rebate Funds to offset a portion of the General Fund reduction.
 - Domestic Violence Shelters: Reduced overall funding by 20 percent, rather than a complete elimination as proposed by the Governor.
- **Emergency Medical Services Authority:** Reduces funding for the California Poison Control System, which provides immediate free

treatment advice and assistance over the phone, for a savings of \$3 million.

- **Department of Mental Health:** Proposes to reduce the Mental Health Managed Care Services and Early and Periodic Screening, Diagnosis, and Treatment (EPDST) Program for a combined General Fund savings of \$92 million.
- **Developmental Services:** Reduces by \$334 million, as proposed by the Governor, through a methodical and inclusive approach with substantial input from the communities that access these services.

HUMAN SERVICES

- **CalWORKs:** Does not eliminate the program, but achieves \$270.5 million in budget year savings by reducing funding to counties, temporarily exempting certain families (e.g., those with very young children) from work requirements, reverting funds, and adjusting caseload estimates.
- **In-Home Supportive Services (IHSS):** Does not make the devastating cuts proposed by the Governor, but achieves \$117.8 million in budget year savings by increasing the share of costs for some recipients and reducing or eliminating services for clients with the lowest levels of need.

In the February 2009 Special Session, the IHSS share-of-cost buy-out was eliminated effective July 1, 2009, for prospective cases only. This proposal, which would become effective September 1, 2009, reduces by 50 percent the state's share of the buy-out for clients who were previously grandfathered in to continue receiving a full buy-out.

Does not reduce worker wages; however, adopts Governor's proposed savings of \$40 million from improved fraud detection.

- **Supplemental Security Income/State Supplementary Program (SSI/SSP):** Adopts modified version of Governor's proposal. Reduces grants for couples who are aged, blind or disabled to federal minimum level (as proposed), but reduces grants for individuals by a lesser amount. Ensures that grants for individuals are close to the poverty line (unlike

Governor's proposal, which would have dropped substantially below). These changes result in General Fund savings of \$115.9 million in the budget year.

In the February 2009 Special Session, SSI/SSP grants were reduced by 2.3 percent, or \$20 for individuals and \$35 for couples per month, effective July 1, 2009, under the assumption that federal funds would not be received at a \$10 billion level. This proposal would further reduce the maximum grants for individuals from \$850 to \$845 per month and for couples from \$1,489 to \$1,407 per month.

- **Foster Care:** Proposes a General Fund reduction of \$36.7 million to foster care programs, including savings of \$26.6 million from a 10 percent reduction to rates for Group Homes, Foster Family Agencies, and placements for Seriously Emotionally Disturbed children.
- **Safety Net and Food Programs for Poor Immigrants:** Does not eliminate Cash Assistance Program for Immigrants (CAPI) or California Food Assistance Program (CFAP), as proposed by the Governor. However, CAPI recipients (approximately 12,000 aged, blind, and disabled legal immigrants who would be eligible for the SSI/SSP program but for their immigration status) will see a decrease in their grants consistent with the reductions adopted in the SSI/SSP program. CFAP would continue to provide food assistance to more than 22,000 low-income legal non-citizens between the ages of 18 and 65, who meet all the eligibility requirements for the federal Food Stamp program but have resided in the United States for less than five years.
- **Alcohol and Drug Programs:** Reduces funding by \$90 million for Proposition 36 programs that provide treatment to substance abuse offenders, but continues to fund treatment under the Offender Treatment Program (OTP). Provides federal Byrne funds of approximately \$60 million to supplement OTP services.

Reduces, by 10 percent, the rates paid to Drug Medi-Cal providers for a General Fund savings of \$8.8 million.

CORRECTIONS AND JUDICIARY

Overall in Corrections: Achieves \$1.2 billion in savings (somewhat less than the Governor's amount). Includes prison and parole reforms (including eliminating parole for low-risk offenders, increasing supervision for higher-risk parolees, bolstering probation supervision, implementing re-entry courts); modification to sentencing laws for "wobblers" (fewer changes than proposed by the Governor); and alternative custody options.

Reduces funds for less effective rehabilitation programs (but not elimination, as proposed by the Governor), and includes unallocated reductions to the Department of Corrections and Rehabilitation, including to headquarters administration (using more realistic assumptions than the Governor's).

➤ Department of Corrections and Rehabilitation

- Reduces \$402.5 million related to targeted reductions in the state prison population by: (1) commuting sentences of undocumented immigrants in our prison system and having them immediately deported by Federal Immigration and Customs Enforcement; (2) changing sentencing options for low-level offenders by eliminating the current sentencing options for specified crimes that may be treated either as felonies or misdemeanors, making them punishable by a jail term rather than state prison; and (3) placing certain lower-rise inmates under GPS monitoring. These proposals will prioritize the incarceration of the most serious offenders.
- Reduces California Department of Corrections and Rehabilitation (CDCR) programs by \$175 million. The CDCR will also have a \$100 million unallocated reduction, at least \$20 million of which will come from headquarters. In addition, funding for building maintenance is being eliminated on a one-time basis in 2009-10. In total, 2009-10 expenditures will be reduced by \$322.6 million.

➤ Judicial Branch

- Reduces funding, by \$168.6 million, by reducing general fund support to the courts by 10 percent. This reduction will be achieved through various measures, including one-day per month court closures, transfer of reserves in various funds, and an increase in fees.

NATURAL RESOURCES AND THE ENVIRONMENT

- **Offshore Oil Drilling:** Does not approve Governor's proposal.
- **Department of Parks and Recreation:** State Parks, assumes enactment of \$15 "park pass" VLF add-on. Funds would be used to avoid park closures and pay for parks-related bond debt service (saves \$145 million annually General Fund [\$70 million in budget year]). This is in lieu of complete closure of California's state parks.
- **Department of Conservation:** Eliminates "Williamson Act" payments of \$34.7 million to counties for Agricultural and Open Space Land Preserves. These subventions currently backfill a portion of revenue lost by local governments when they enter into voluntary agreements with land owners for lower property tax assessments when those land owners agree to use the land only for agricultural or open space purposes.
- **Forestry and Emergency Services:** Adopts Governor's Emergency Response Initiative, but does not permit out-year expenditure plans for these funds as presented by the Governor – leaving out-year discussion of these funds for future budget deliberations. This surcharge would average approximately \$48 a year per insurance policy holder and generate \$120 million in additional revenue in 2009-10. This proposal would delay all enhancements to emergency response proposed in the January 10 budget, generating \$78 million in General Fund savings by offsetting current baseline costs for CalFIRE.
- **Office of Environmental Health Hazard Assessment:** Shifted \$5.7 million from GF to special funds. This created \$4.1 million in GF savings over the Governor's proposal.

STATE GOVERNMENT

- **Consolidations and reorganizations:** Adopts Governor's proposed savings from consolidations and reorganizations.
- **Information Technology Savings:** Reduces funding for state information technology services, consistent with recent IT consolidation, and provides the Office of the Chief Information Officer (OCIO) additional authority to achieve another \$100 million in savings.
- **Cash Deferrals:** Adopts Governor's cash deferral proposals.
- **Employee Compensation:** Rejects Governor's proposal to reduce salaries by 5 percent – thereby maintaining a 2-day furlough for all employees.

Assumes some savings that will be achieved if proposed labor agreements are not ratified by the Legislature. General Fund savings are estimated at \$60 million in 2008-09 and \$150 million in 2009-10.

- **Paycheck Deferral:** Defers June 30, 2010 state employee paychecks to July 1, 2010 to achieve budget savings.
- **Rural Health Care Equity Program (RHCEP):** Proposes to eliminate funding for the RHCEP (except for Bargaining Unit 5, until its existing contract expires) which provides reimbursements for certain health care expenses for State employees who do not have access to a Health Maintenance Organization (HMO). Estimates annual savings of \$15.7 million. The 2008-09 approved budget eliminated payments through the RHCEP for retired annuitants.
- **Public Employees' Retirement System (PERS):** Rejects the Governor's proposal to save an estimated \$132.2 million, beginning in January 2010, by contracting for lower cost health care coverage either through PERS or directly from an insurer. This change could conflict with existing collective bargaining contracts. Instead assumes PERS' 2010 final adopted health and dental premium rate increase will be less than the nine percent increase assumed in the February enacted budget and scores \$50 million in savings. Additionally, recognizes the plan

adopted by the PERS Board to rebate, via a two-month payment holiday in 2009-10, \$100 million in excess Preferred Provider Organization premiums paid by the state.

- **State Compensation Insurance Fund:** Adopts the Governor's proposal to sell a portion of the State Compensation Insurance Fund (SCIF) to a private entity for an estimated \$1 billion. The SCIF would remain the "insurer of last resort". SCIF was established in 1914 as a self-supporting, non-profit enterprise that provides workers' compensation insurance to California employers with no financial obligation to the public.
- **Department of Industrial Relations:** Shifts the majority of the remaining General Fund support in the Department of Industrial Relations (DIR) budget to fee-support.
 - Employer fees will be increased to fund the Occupational Safety and Health Program and the Labor Standards Enforcement Program. Similar fees on employers were increased in the 2008-09 budget to address funding shortfalls. Ongoing cost reductions beginning in 2010-11 will produce over \$60 million in GF savings.
- **Department of General Services:** Delays repairs to the State Capitol building and park, for one year, providing \$6.6 million in savings.

LOCAL GOVERNMENT AND TRANSPORTATION

- Does not suspend Proposition 1A in 2009-10. Initially, the May Revision proposed to borrow \$1.98 billion from local governments through the suspension of Proposition 1A (of 2004). Suspension, which requires legislation, allows the state to divert to schools up to eight percent of property tax revenues of cities, counties, and special districts to counties and special districts. Repayment, with interest, must be made within three years. The May Revision also proposed legislation to authorize a joint powers authority to facilitate local government borrowing against the state's repayment promise.
- Adopts the Governor's proposals on public transit funds. This includes new General Fund relief of \$336 million by directing new transit

“spillover” revenues to transportation-related debt service. In addition, the budget assumes an additional \$300 million from spillover funds for GF relief, generally as a result of higher anticipated gasoline prices. Finally, directs \$315 million in transit revenue formerly directed to home-to-school transportation, to transportation-related debt service.

- “Realigns” \$300 million Vehicle License Fee (VLF) funds from the Department of Motor Vehicles to counties. Counties would use funds to support CalWORKs grants.
- Driver License (DL) / Identification Card (ID) Fees. Increases the basic DL fee by \$28 dollars, to \$56 dollars, and proportionally increases other DL/ID fees. Realignment in the Human Services budget area resulted in a shift of \$300 million in Vehicle License Fee (VLF) revenue – this revenue is currently being used for Department of Motor Vehicles (DMV) administrative costs, but would be redirected to local governments. In conformance with this new DMV funding model, there is a need to raise additional revenue in the Motor Vehicle Account (MVA) to partially backfill for the VLF shift. The Administration had separately requested a \$3 increase in these fees. Since the DL fee is generally only paid once every five years, the annualized cost to carry a DL is increased from about \$5.60 to about \$11.20. This fee increase would be effective October 1, 2009, and would increase Motor Vehicle Account revenues by about \$173 million in 2009-10, and by about \$230 million in 2010-11 and ongoing.
- Institute a user fee on gasoline and diesel fuel. Enacts a new 18 cents-per-gallon gasoline and diesel fee. Separate legislation in this budget package (either ABx3 39 or ABx3 2) repeals the existing 18 cents-per-gallon gasoline and diesel excise tax – that legislation then increases General Fund taxes by an equivalent amount. The new fees would raise the same amount of revenue as the repealed taxes – about \$3.1 billion on a full-year basis. Consumers’ cost at-the-pump would be unchanged. The fee revenue associated with on-road use would flow to the new Highway Users Revenue Account (HURA). For purposes of allocation, the funds in the HURA would be allocated in the same manner as statute provides for the Highway Users Tax Account (HUTA). The new fee revenue in the HURA would similarly be directed to General Fund relief.

- Adopts the Governor's proposal to redirect the local gas tax for General Fund relief, but limits the shift to two years instead of permanent (either SB 18 or AB 4, in the 3rd Extraordinary Session). In 2009-10, the amount of the shift would be \$986 million, and in 2010-11, the shift would be about \$750 million. These amounts are consistent with the limit on bond debt payment of 25 percent of fuel and weight fee revenues outlined in Article XIX, Section 5 of the California Constitution. Future legislation can provide local governments with new opportunities to raise funds for public transit and local transportation services.
- Extends for two years a 2008-09 shift of 5 percent (or a minimum of \$350 million) of property tax increment revenues from redevelopment agencies (RDAs) to county Educational Revenue Augmentation Funds (ERAFs). The shift of funds to ERAF will reduce the state's General Fund obligation under Proposition 98 by an equal amount, resulting in K-12 education savings. New General Fund budget savings of \$350 million in 2009-10 and \$350 million in 2010-11 would result. In addition, the language amends 2008-09 language to specify the shifted funds go to schools districts that overlap with the individual redevelopment areas.
- Suspends Open Space Subventions. Suspends state subventions to local governments (primarily counties) under the Williamson Act Program for a General Fund savings of \$34.7 million. Under this longstanding program, the state backfills a portion of the revenue lost by local governments when they enter into contracts with land owners to limit property tax assessments for lands that are maintained as open space or agricultural lands. Also discussed under the Resources heading.

REVENUE AND TAXATION

Revenue Accelerations

- **Quarterly prepayments.** Accelerates \$610 million of Personal Income Tax and Corporation Tax revenues into 2009-10 by increasing the June (second) quarterly estimated payment from the current 30 percent of annual tax liability to 40 percent, beginning June 2010. The percentage due with the first quarterly estimated tax payment (due in April) is 30 percent, so the total amount due in the first half of the year would be 70 percent. However, the proposal would eliminate the third quarterly estimated payment (now 20 percent of annual liability) and increase the

final quarterly payment (due in December) from the current 20 percent to 30 percent of annual tax liability.

- **Payroll Withholding.** Increase payroll withholding schedules by 10 percent, effective January 2010, to accelerate \$1.7 billion of Personal Income Tax revenue into 2009-10.

Revenue Enforcement and Administration

- **Financial Institutions Records Match (FIRM):** Adopts the Franchise Tax Board (FTB) FIRM proposal. FIRM requires financial institutions to perform quarterly matches of their account records with a file of tax delinquents provided by the Franchise Tax Board (FTB) in order to identify assets that can be applied to pay the delinquent tax debts. This provision improves collections, but does not change tax liability. Revenue gain of \$27 million in 2009-10, \$60 million in 2010-11, and about \$100 million in subsequent years.
- **Contractor withholding:** Imposes withholding on independent contractors. Effective January 1, 2010, extends income tax withholding on payments to independent contractors. Requires businesses and government entities to withhold three percent of payments for goods or services to independent contractors that currently require the filing of a federal 1099-MISC. The amount withheld would be credited against the state income tax liability of the contractor, as with wage withholding. This provision accelerates revenue and improves compliance, but does not change tax liabilities. Provisions reflect AB 12X (First Extraordinary Session). Revenue gain of \$2.0 billion in 2009-10, revenue gain of \$60 million in 2010-11, minor losses in 2011-12 and 2012-13, then annual increases of about \$300 million per year from increased compliance.
- **Backup withholding:** Generally conforms California to federal income tax backup-withholding rules related to various non-wage payments. Requires a business to withhold seven percent of reportable payment of interest, dividends, compensation for services, and other forms of income if the IRS determines a condition for withholding exists (such as significant underreporting of non-wage payments by the recipient on tax returns). Revenue gain of \$26 million in 2009-10 and ongoing revenue gain of about \$26 million.

- **Sales tax "nexus":** Requires out-of-state sellers, such as Amazon, that pay commissions to California firms or residents for sales referrals (often through a website link) to collect sales tax on their sales to California residents. This provision improves compliance, but does not change tax liability. Existing law requires Californians to pay equivalent use tax on these purchases, but compliance is low. Revenue gain of \$48 million and ongoing revenue gain of about \$110 million.
- **Non-retailer registration at BOE:** Requires non-retailers to register with the Board of Equalization (BOE). Businesses that provide services will be required to register with the board and file annual use tax returns by April 15. The annual use tax return and payment applies to purchases on which sales tax was not collected (generally from out-of-state sellers), excluding vehicles, vessels, and aircraft. This provision increases compliance, but does not change tax liabilities. Revenue gain of \$28 million in 2009-10, revenue gain of \$57 million in 2010, and potentially larger amounts in future years. Also, an increase in local use tax revenues.
- **Abusive tax shelters:** Strengthened definition of abusive tax shelters. Discourages tax avoidance and the use of abusive tax shelters by defining a “potentially abusive tax avoidance transaction” as: (1) a tax shelter; (2) an undisclosed reportable transaction; (3) a listed transaction; (4) an entity, investment plan or arrangement, or other plan or arrangement that has the potential for tax avoidance or evasion, as identified by the Secretary of the Treasury or the Franchise Tax Board; (5) a gross misstatement; or (6) a transaction subject to the non-economic substance transaction understatement penalty. FTB indicates that the strengthened definition will result in increased penalty assessments. Revenue gain of \$4 million in 2009-10, revenue gain of \$10 million in 2010-11, and ongoing revenue gain of about \$15 million.
- **License revocation:** Revocation of licenses for delinquent tax payments. Permits the state to suspend state occupational and professional licenses because of unpaid income tax liabilities. Allows taxpayers to avoid suspension by entering into an installment agreement with FTB. Revenue gain of \$10 million in 2009-10, and ongoing revenue gain of about \$15 million to \$20 million.

New Tax Revenues

- **Imposes an oil severance tax.** Imposes a 9.9 percent tax on the gross value of each barrel extracted from California. Stripper wells are exempt from the tax whenever the average price of the oil they produce falls below \$30 per barrel. Effective October 1, 2009. Annual cost to Department of Conservation of about \$10 million to administer the program. Revenue estimates assume current price of about \$60 per barrel for California crude oil. Revenue gain of \$830 million in 2009-10 and about \$1.1 billion ongoing.
- **Increases cigarette taxes:** Raises state cigarette excise taxes (currently \$.87 per pack) by an additional \$1.50, and imposes an equivalent increase for other tobacco products, effective October 1, 2009. Revenue gain of \$1.0 billion in 2009-10, revenue gain of about \$1.2 billion in 2010-11, and decreasing about three percent per year thereafter.